

TESTIMONY OF
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Madam Chairman and Members of the Tribunal:

I am grateful for the opportunity to appear before you and to participate in the presentation of the direct case of the television program supply industry.

The Copyright Royalty Tribunal has a formidable task in seeking to distribute the royalties paid by cable television systems under §111 of the Copyright Act of 1976. That task is particularly complex because the Act does not prescribe the criteria to govern the distribution of royalty fees. Rather, Congress determined that it would not be appropriate to specify particular limiting standards but, instead, urged the Tribunal to consider all pertinent data and arguments presented by the claimants (see H.R. Rept. No. 94-1476, 94th Cong., 2d Sess. 97 (1976)).

Among the pertinent information and considerations which we believe the Tribunal should consider in arriving at a fair and equitable distribution formula are certain principles derived from §111 itself. Thus, while the Act is silent on specific direction to the Tribunal, there are, we believe, certain underlying principles on which the compulsory license is based which should be given controlling weight by the Tribunal.

My principal aim, therefore, is to set out and explain the

governing statutory provisions for such guidance as it furnishes this Tribunal in arriving at appropriate standards and criteria for distribution of the cable royalty funds.

A review of Section 111 of the Copyright Act discloses that it is highly complex and based on a series of detailed and intricate provisions. I will first summarize the general principles underlying the section, followed by a more detailed analysis of the cable royalty provisions.

I. General Principles

1. Cable systems should pay royalties under a compulsory license

In the view of Congress, the impracticability and burdensome effect of requiring a system of copyright liability, whereby licenses are negotiated by individual cable systems with every copyright owner whose work is retransmitted, led to the adoption of a compulsory license scheme for the retransmission of over-the-air broadcast signals.

2. The compulsory license should extend to and be consistent with FCC rules and regulations

Congress further recognized that there was a critical relationship between the copyright liability of cable television systems and the complex and intricate rules and regulations governing cable television systems adopted by the Federal Communications Commission. It resolved the potentially divergent regulatory policies embodied in copyright and communications law by extending the copyright compulsory license to the

retransmission of all broadcast signals permissible under the rules, regulations, or authorizations of the Federal Communications Commission. In short, the two regulatory approaches are joined and made interdependent under the new Copyright Act.

3. The compulsory license should be subject to certain limitations as a matter of copyright policy

Notwithstanding the extension of the compulsory license to the carriage of all broadcast signals permissible under FCC rules, Congress made the compulsory license subject to certain limitations and conditions designed as safeguards for copyright owners. These include compliance by all cable systems with certain notification and reporting requirements, payment of royalty fees at periodic intervals, stringent prohibitions on the substitution or deletion of program content or commercial advertisements, careful geographic limits on those cable systems permitted to carry Canadian and Mexican stations under the compulsory license, and restricted conditions under which cable systems located on U.S. territory outside the 48 contiguous states may tape and replay programs.

4. Cable-copyright fees should be limited to payment for the retransmission of distant non-network programs

Based on the negotiated settlement advanced by NCTA and MPAA, Congress agreed that cable copyright fees should be limited to payments for the retransmission of distant non-network programs. Under this formula there is no payment

for the carriage of local or network signals by a cable television system. The rationale underlying this determination is that the retransmission of local or network signals does not harm the copyright owner because the license agreements negotiated with respect to both local or network programs contemplate a fee based on the program reaching the market or markets served. By contrast, the retransmission of distant non-network programming harms the copyright owner by adversely affecting his ability to exploit the work in the distant market, a market not covered by the basic license agreement. It is also of direct benefit to the cable system by enhancing its ability to attract subscribers and increase revenues (see H.R. Rept. No. 94-1476, 94th Cong., 2d Sess., p. 90). Accordingly, the fee schedule adopted under the Act is tailored to reflect payment for distant non-network programming only.

II. Royalty Payments

The computation of royalty fees under the bill is based on two general principles. The first is that gross receipts for purposes of the computation are limited to receipts for the basic service of providing retransmissions of broadcast signals. Other revenues derived from installation charges, pay cable fees, and advertising are not included in determining total gross receipts.

Second, the liability of cable systems is limited to payment for the retransmission of distant non-network programming.

There is no payment for local signals or network programs.

In calculating the percentage that is applied to gross receipts to determine the fee for retransmission of distant non-network programs, a two-step formula is used for systems with semi-annual gross receipts of \$160,000 or more. Systems with semi-annual gross receipts of less than \$160,000 are subject to a special small system reduced fee.

1. Systems with semi-annual gross
 receipts of \$160,000 or more

The two-step formula for systems whose semi-annual gross receipts total \$160,000 or more involves first the assignment of a value called a "distant signal equivalent" (DSE) to all distant signals carried by a cable system. Distant signals are defined as "may" carry rather than "must" carry signals, ^{1/} under FCC rules.

In determining which signals are "distant" or "may" carry signals under FCC rules, cable systems apply a process of elimination. They first calculate which signals are "local" or "must" carry signals. Under FCC rules there are basically three criteria for determining "local" or "must" carry signals. First,

1/ The critical interrelationship of FCC rules with the new Copyright Act is underscored by the adoption of an FCC formula to distinguish between "local" and "distant" signals. However, the interrelationship is limited in one significant respect. Under the new Copyright Act, the FCC rules distinguishing between "local" and "distant" signals are frozen as of April 15, 1976.

and most important, a cable system located within 35 miles of a television market must carry all signals within that market. Second, a cable system outside the 35-mile zone of any television market must carry all television signals within whose Grade B contour^{2/} the cable system lies.^{3/}

The third criterion is the "significant viewing" standard. This standard applies to all cable systems and is defined in terms of (a) the number of hours that a non-cable home in the community views a particular television station, and (b) the amount of non-cable audience that a particular television station attracts. If the station meets the required percentages, it is defined as "significantly viewed" in the community where the cable system is operating and may insist upon its signal being carried by the cable system.^{4/}

After eliminating the "local" or "must" carry signals from its list, a cable system then determines its total DSE value under the Act.

In computing the DSE total, the cable system assigns different

2/ The Grade B contour is a predicted, theoretical measurement computed in engineering terms without regard to terrain. It delimits an area in which a television signal should be receivable most of the time.

3/ The rule also applies to a cable system located within the 35-mile zone of a smaller television market and within the Grade B contour of another smaller television market.

4/ The FCC rules contain a list of significantly viewed stations in every county of the United States.

values to distant independent, network and non-commercial educational stations. Distant independent stations are counted as one (1) DSE and distant network and educational stations at one-quarter (1/4) DSE.^{5/} These values are then combined to determine the total DSEs for a particular system.

After determining the total DSEs, the second step involves computing the applicable percentage rate which is applied to gross receipts. Here the statute gives the rates as follows:

0 to 1 DSE	.675%	^{6/}
1 to 2 DSE	.425%	
2 to 3 DSE	.425%	
3 to 4 DSE	.425%	
4 to 5 DSE	.200%	
and each DSE thereafter	.200%	

The DSEs of distant stations carried on a part-time basis are computed at their fractional value.

The following example illustrates the computation. A cable system carries two distant independent stations, one distant

^{5/} Different values were assigned to independent, network and educational stations because of the different amounts of viewing of non-network programming carried by such stations. It was estimated, for example, that the viewing of non-network programs on network stations approximated 25% of overall viewing of the station, and accordingly the value assigned to the carriage of distant network stations is intended to cover the non-network programming of such stations. The definition of "network station" is limited, however, to an affiliate of one or more of the domestic television networks. Thus, retransmission of a Canadian or Mexican station would be considered retransmission of an "independent" station. The same would be true of "specialty" stations.

^{6/} The Act makes clear that if a cable system has zero DSEs, it pays, nonetheless, the rate of .675% for the privilege of transmitting distant non-network programming.

network station, one distant educational station and has a semi-annual gross of \$300,000. Total DSEs are, therefore, 2.5.

The royalty percentage for 2.5 DSEs is computed by adding:

.6750	(0 to 1 DSE) to
.4250	(1 to 2 DSE) to
.2125	(1/4 of .425 + 1/4 of .425) (2 to 3 DSE)
<u>1.3125</u>	is the total percentage

Applied to \$300,000 the semi-annual royalty fee is \$3,936.

A further complicating factor exists, however, where systems in this category (semi-annual gross of more than \$160,000) substitute or add programs on distant independent signals pursuant to applicable FCC rules. When the FCC permits a cable system, at its discretion, to delete programs of primarily local interest originated by a distant independent station (as contrasted with the mandatory deletion requirements of the syndicated program or sports program exclusivity rules), and a "live" program (e.g., a sports event) is substituted, then an additional DSE value is assigned. The fraction is determined by assigning to the numerator the number of days in the year on which the "live" substitution occurs, and by assigning to the denominator the number of days in the year. Further, the discretionary exception is limited to those FCC rules in effect on the date of enactment of this legislation. If subsequent FCC rule amendments or individual authorizations enlarge the discretionary ability of cable systems to delete and substitute programs, such deletions and substitutions would be counted at the full value assigned the particular type of station provided above.

Two further exceptions pertain to the late-night or specialty programming carriage rules of the FCC or to a station carried on a part-time basis where full-time carriage is not possible because the cable system lacks the activated channel capacity to retransmit on a full-time basis all signals which it is authorized to carry. In this event, the values for independent, network and non-commercial, educational stations set forth above, as the case may be, are determined by multiplying each by a fraction which is equal to the ratio of the broadcast hours of such station carried by the cable system to the total broadcast hours of the station.

2. Systems with semi-annual gross receipts
of less than \$160,000

Many smaller cable systems in the U.S. are located in sparsely populated areas and therefore carry a larger number of distant signals than systems in heavily populated areas. In light of this consideration and because smaller cable systems may be less able to shoulder the burden of copyright payments than larger systems, Congress created a special reduced fee category for systems with semi-annual gross receipts of less than \$160,000. The royalty fee for such cable systems is based on a straight percentage formula subject to a further limitation for systems with semi-annual gross receipts of less than \$80,000. In either case the fee is computed without regard to the number of distant signals, if any, carried by the system.

Systems with semi-annual gross receipts of between \$80,000 and \$160,000 pay .5 of 1% on the first \$80,000 and 1% of any amount over \$80,000. Thus, a system with semi-annual gross receipts of \$100,000 pays \$400 $(.005 \times \$80,000)$ + 200 $(.01 \times 20,000)$ or \$600.

Systems with semi-annual gross receipts of less than \$80,000 also pay .5 of 1% on gross receipts but subject to the limitation that an amount equal to the difference between actual gross receipts and \$80,000 is first subtracted from actual gross receipts. Thus, if actual gross receipts are \$60,000 for the semi-annual period, the fee is determined by subtracting \$20,000 (the amount by which \$80,000 exceeds actual gross receipts) from \$60,000 and applying .5 of 1% to the \$40,000 result. The fee in this case, therefore, would be \$200. Gross receipts under this formula may in no case be reduced to less than \$3,000 (or a fee of \$15).

III. Analysis

Based on the foregoing review of the royalty payment provisions of §111 of the Copyright Act, it is clear that the Act provides two sets of criteria for the determination of the amount paid by cable systems for the retransmission of distant signals. First, it is provided that different cable systems pay different amounts of royalties, based on the gross receipts of the cable system. Thus, a system with semi-annual gross receipts of less than \$160,000 will pay a percentage

of its gross receipts for all the distant signals carried on the system, regardless of number. By contrast, systems with semi-annual gross receipts of more than \$160,000 will pay on a per signal basis, based on the complex formula described above. This difference in payment is critical, in our judgment, because it suggests that the amounts paid for the signals carried by the larger systems may represent a disproportionate share of the total royalties as compared with the amounts paid for the signals carried by the smaller systems.

This disparity in payments is in fact reflected in the data accumulated by the MPAA. As the testimony of Allen Cooper indicates, of 3,743 cable systems filing statements of account for the first six months of 1978, only 865 systems, or 23.1%, fell into the category of systems with semi-annual gross receipts of more than \$160,000. Nevertheless, these 865 systems contributed \$5,290,263 to the total royalty pool of \$6,059,418 collected for the same six month period. Thus, 23.1% of the systems filing paid 87.3% of the royalties collected. Analysis of the programming included in the stations retransmitted by these cable systems would therefore appear proper and particularly relevant in arriving at an equitable distribution formula.

The second major principle to be derived from the statutory scheme is that with respect to the cable systems whose semi-annual gross receipts exceed \$160,000, Congress created an important and further distinction based on the type of station carried. This distinction is reflected in the so-called "DSE"

equivalents discussed above. Thus, independent stations are given a relative weight equal to four times the weight of either network or educational stations. It reflects a Congressional determination of the relative value to be accorded these signals, both for payment and, in our view, distribution purposes.

It becomes critical, therefore, to separately analyze the royalty payments made by cable systems whose semi-annual gross receipts exceed \$160,000 under the compulsory license to determine the relative value of each distant station carried by such cable system. And, in determining this value, we believe that the relationships fixed by Congress, as respects independents, network stations and educational stations, should be maintained. Thus, for example, if a cable system retransmits the programs of two stations -- one an independent and the other a network affiliated station -- it is essential to weigh or value the programs carried by those stations on the basis of the amounts paid by the cable systems in determining the respective royalty shares of the copyright owners. Using the ratios fixed by Congress, the relative weights should be four to one or 100% to 25%.

Stated differently, if a cable system has 1.25 DSEs for the carriage of one independent station and one network affiliated station and pays royalties of \$10,000 for the carriage of both such signals, the royalty payments under the statutory scheme would be divided into \$8,000 for the independent station and \$2,000 for the network affiliated station. We believe that these

shares should be maintained in determining a distribution formula by the Tribunal. The formula should recognize that substantial differences exist under the statutory scheme for the payment of different types of stations, that these differences are critical and that these differences should be maintained in fashioning a distribution formula. Otherwise some copyright owners whose programming was not considered as valuable by Congress as the programming of other copyright owners would share equally in the distribution process.

In sum, we believe the share of a copyright owner should be determined on the basis of the contribution its program makes to the cable royalty payment. We have designated this basic principle as the "fee-generated" approach. This principle governs our methodology and analysis and we believe should be given controlling weight in the adoption of an equitable distribution formula.